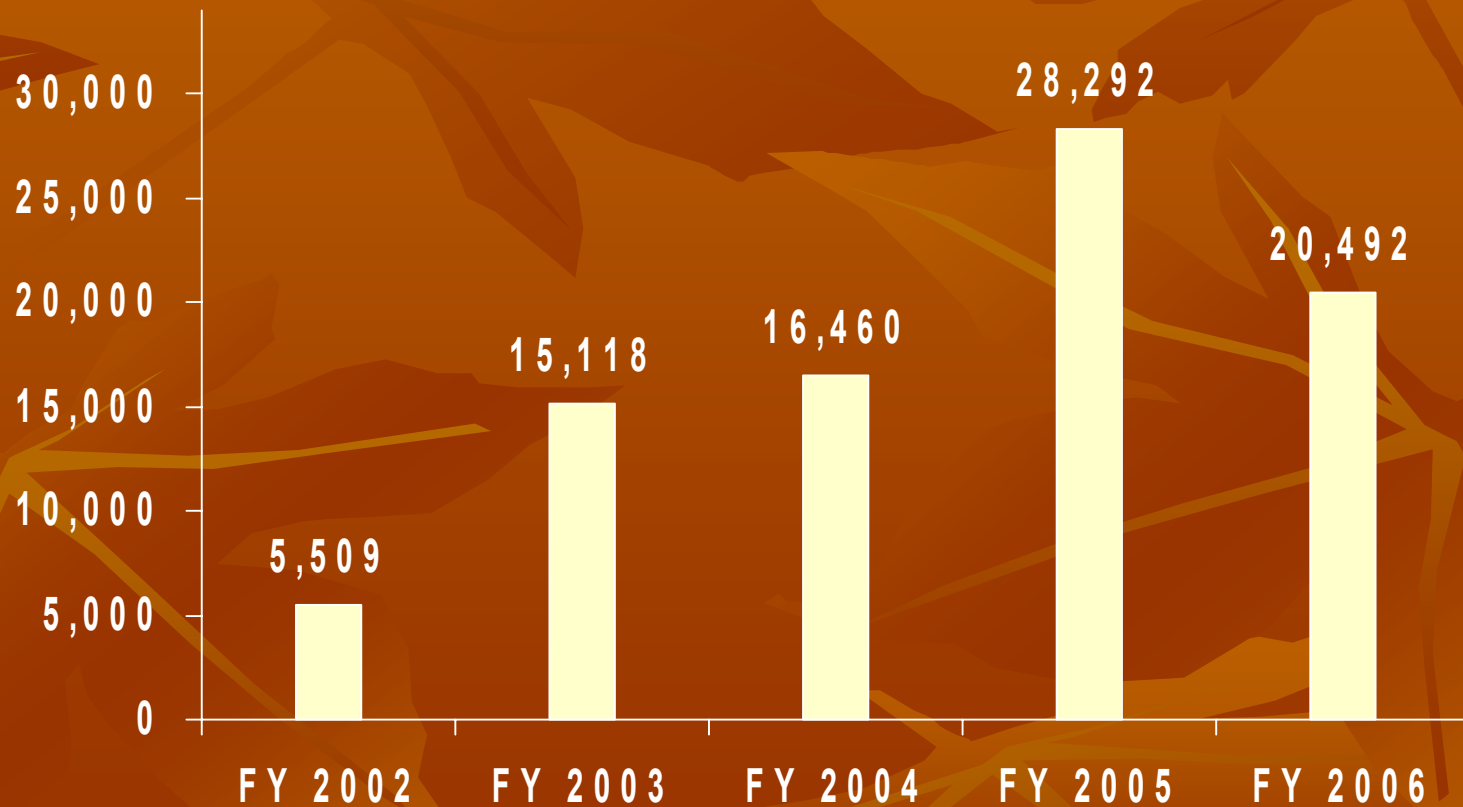


# Questionable Refund Program (QRP)

# Background and Overview of TAS Initiated Changes to the QRP

- The Criminal Investigation (CI) QRP was established in 1977 as part of the IRS Revenue Protection Strategy.
- The purpose of the QRP is to identify fraudulent refund claims and place a hold or “freeze” on those refund claims that appear to contain false information.
- The processes used in the QRP involve reviewing questionable refunds and preventing the issuance of refunds in those cases where there appear to be indications of fraud. An example of a common situation that would be considered questionable would be evidence that a Form W-2 was altered to inflate withholding credits.

In 2003, CI began using data mining software allowing it to scan millions of returns. During this time, the TAS inventory of QRP cases began to dramatically increase.



The National Taxpayer Advocate (NTA) addressed the QRP as a Most Serious Problem in the 2003 Annual Report to Congress directing attention to the high numbers of QRP frozen refund claims and the lack of notice provided to affected taxpayers.

TAS and CI conducted a joint statistically valid study of TAS QRP frozen refund cases. Some of the objectives of the study were to determine:

- The percentage of innocent taxpayers whose refunds were frozen
- Economic data of taxpayers with frozen refunds
- The average length QRP refunds were frozen

## Some significant findings of the study included:

- Most of the returns in the sample were in the lower income strata and on average the frozen refund represented 25 percent of the taxpayers' yearly income.
- Approximately 75 percent of the taxpayers claimed the Earned Income Tax Credit (EITC).
- 66 percent of the cases in the sample were not fraudulent and over 80 percent received at least a partial refund.
- Taxpayers had to wait an average of nine months to receive refunds. One out of every five in this group waited for well over one year.
- Over half of the taxpayers had an adjusted gross income below \$13,000 and many ultimately received the EITC.

In the 2005 Annual Report to Congress, the NTA discussed the results of the study and made recommendations for improving the QRP, many of which have been implemented.

Some of the recommendations include significant changes to:

- Existing QRP procedures
- Notification of refund freeze to taxpayers
- Reduced timeframes for releasing refunds or taking immediate additional action.

# Overview of New QRP Procedures

Prior procedures allowed CI a minimum of 180 days to verify income, withholding or credit claimed on a return. That timeframe was often not met because there was no systemic process in place to release them.

- Beginning in August 2006, CI must take additional action to continue holding the refund or it is systemically released five weeks from the date the refund was frozen.

Prior procedures did not require notification to taxpayers of the refund freeze prior to or after expiration of the 180 day period.

- Once CI has determined there is indication of incorrect income, withholding or credit, they must take action within five weeks to continue holding the refund. When that determination is made, Notice CP05 will automatically generate to the taxpayer.



Notice CP05 informs taxpayers their return is being reviewed and the refund held to ensure accuracy of:

- Income reported on the return;
- Income tax withholding credits reported on the return; and/or
- Claims for refundable tax credits made on the return.

Notice CP05 advises taxpayers:

- Not to send any information at that time
- The refund will be received or another contact initiated within three weeks of the date of the notice
- To call (800) 829-1040 if the taxpayer has not received the refund or additional contact within three weeks of the date of the notice
- To call TAS for assistance with financial burdens or hardships



- Three weeks after issuance of the CP05, CI will either release the refund or continue to hold the refund because of questionable income, withholding and/or credits claimed on the return.
- If the refund is not released, resolution of the return will fall into two different categories:
  1. Questionable returns with income and withholding only
  2. Questionable returns with income, withholding and refundable tax credits

## Cases Involving Questionable Income and Withholding Only

CI will issue Letter 4115C to the taxpayer requesting verification to support the income and withholding claimed on the return. The letter informs the taxpayer the refund is being held until the IRS completes a review of the return based on one of three situations:

- The IRS has information that the Form(s) W-2 attached to the return may not have reported the taxpayer's correct information and/or withholding.
- The employer or payer informed the IRS the taxpayer wasn't employed by the company at any time during the tax year.
- The IRS is unable to locate the employer or payer listed on Form(s) W-2, W-2G or 1099 submitted with the taxpayer's return.

Letter 4115C requests the taxpayer submit information to support the wages and withholding on the return. Information may include:

- A copy of periodic pay statements or check stubs clearly identifying the date, gross income received and withholding, or
- A letter from the employer on company letterhead or stationery indicating the dates of employment and the gross amount of wages paid and withholding deducted.

If the taxpayer did not file the return in question, the taxpayer is asked to sign and return Form 12483, Declaration Statement, to have the records corrected accordingly.

- The taxpayer is asked to reply within 30 days. The letter informs the taxpayer if a response is not received within 30 days, a notice of claim disallowance with appeal rights will be issued (Letter 105C for full disallowance or Letter 106C for partial disallowance).
- CI will hold the accounts in suspense for 45 days to allow sufficient time for the taxpayer to respond.
- If the taxpayer does not respond or responds but cannot substantiate the income and withholding on the return, the case will be referred to the IRS Accounts Management operation for issuance of the 105C/106C disallowance letter.

## Cases Involving Questionable Income, Withholding and Refundable Tax Credits

- When CI determines there is questionable information on the return and refundable credits such as Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) are claimed, CI will refer the return to the IRS Examination operation for statutory processing.
- Letter 4116C will be sent to the taxpayer only if the taxpayer inquires about the status of the refund. The letter informs the taxpayer of the referral to Examination and to expect further contact within 60 days.
- If the taxpayer does not inquire about the status of the refund, no letter will be issued. Examination should contact the taxpayer within 60 days from the date CI makes the referral to them.

## Prior Year Frozen Refund Clean-Up

Notice CP05A was developed to resolve prior year refunds (tax year 2004 and prior) still frozen with no subsequent action by either CI or Examination. These systemically generated notices began issuing in August 2006 each week. CI initially expected this “sweep” to take six months or more due to the volume of refunds still frozen and is currently still underway.

- Notice CP05A differs from Notice CP05 in that it does ask taxpayers to verify income, withholding and tax credits.
- CP05A advises the taxpayer to respond directly to CI. Depending on whether or not the taxpayer responds and whether or not there are refundable credits claimed, CI will refer the case to either the Accounts Management operation for disallowance or Examination for statutory processing.



## Next Steps

- IRS Executive Steering Committee - NTA, CI, Compliance (Examination), Submission Processing and Accounts Management
- Significant decrease in TAS QRP cases since implementation of new processes.
- Continued emphasis, monitoring and coordination
- Further enhancements and additional notices planned for 2007 processing season